

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

CITY OF FRANKLIN	)	
	)	
COMPLAINANT	)	
	)	
VS.	)	CASE NO. 92-084
	)	
SIMPSON COUNTY WATER DISTRICT	)	
	)	
DEFENDANT	)	

O R D E R

Simpson County Water District ("Simpson District") has moved for recovery of \$184,948.95 of charges which the City of Franklin ("Franklin") assessed without Commission approval. Its motion poses the following issue: May the Commission retroactively approve the rates which a municipal utility charges a public utility for wholesale utility service? Finding that KRS Chapter 278 and case precedent prohibit retroactive rate-making, the Commission grants Simpson District's Motion for Recovery and orders that a hearing be held to determine the amount of charges improperly assessed.

Before May 1994 Simpson District purchased its total water requirements from Franklin.<sup>1</sup> In 1967, Simpson District and Franklin executed a water supply contract to govern this arrangement. In 1982 and 1986, they executed supplemental agreements which specified the rate for the water. The 1986

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<sup>1</sup> For a detailed chronology of the dispute, see Appendix 1 of this Order.

Supplemental Agreement specified a rate of 84.78 cents per 1,000 gallons for the next five years. It further limited any increase in the rate which Franklin charged to Simpson District to the same percentage of increase assessed to Franklin's other customers.

In June 1990, Franklin increased its rate to Simpson District 59 percent to \$1.3478 per 1,000 gallons. In May 1991, Franklin again increased its rate to Simpson District to \$1.68 per 1,000 gallons. Simpson District contends that, contrary to the 1986 Supplemental Agreement, Franklin did not increase its retail rates by the same percentage. Maintaining that the increases violated the 1986 Supplemental Agreement, Simpson District refused to pay the increased rate and paid only the 1986 Supplemental Agreement rate.

In October 1991, Franklin brought suit in Simpson Circuit Court against Simpson District to collect the unpaid rates. Finding that the Commission had jurisdiction over the contract, Simpson Circuit Court dismissed the action for lack of subject matter jurisdiction.<sup>2</sup> Franklin successfully appealed to the Kentucky Court of Appeals.<sup>3</sup> Simpson District in turn appealed to the Kentucky Supreme Court which, in Simpson County Water District v. City of Franklin, Ky., 872 S.W.2d 460 (1994), reversed the Court of Appeals and affirmed the Simpson Circuit Court decision.

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<sup>2</sup> City of Franklin v. Simpson County Water District, No. 91-CI-00184 (Simpson Cir. Nov. 12, 1991).

<sup>3</sup> City of Franklin v. Simpson County Water District, No. 91-CA-002675-MR (Ky. Ct. App. Jan. 8, 1993).

In April 1993, while Simpson District's appeal to the Supreme Court was pending, Franklin threatened to discontinue water service to Simpson District unless it paid its arrearage or posted bond. After unsuccessfully seeking a temporary injunction from Simpson Circuit Court, Simpson District agreed to pay Franklin's demanded rate in lieu of posting bond. From April 23, 1993 until May 19, 1994, Simpson District paid the demanded rate under protest.

On March 4, 1992, while appealing the Simpson Circuit Court's dismissal of its action against Simpson District, Franklin filed a complaint against Simpson District with the Commission. It sought, among other things, approval of its current rates. Finding that it lacked jurisdiction over municipal utilities, the Commission dismissed the complaint.<sup>4</sup> Franklin then brought an action for review of the Commission's Order. Although Franklin Circuit Court affirmed the Commission's Order, the Kentucky Court of Appeals, based upon the Simpson County decision, reversed and remanded the matter to the Commission.<sup>5</sup>

Simpson District subsequently moved for recovery of \$184,948.95 in overcharges collected between April 23, 1993 and May 19, 1994. This amount reportedly represents the difference between the cost of water which Simpson purchased at Franklin's current

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<sup>4</sup> Order of May 26, 1992.

<sup>5</sup> City of Franklin v. Kentucky Public Service Commission and Simpson County Water District, No. 93-CA-001072-S (Ky. Ct. App. May 6, 1994).

rate and the cost of water under the 1986 Supplemental Agreement's rate.

Simpson District's motion poses the following issue: May the Commission retroactively approve a municipal utility's rates for wholesale utility service? If the Commission lacks the authority to approve retroactively a municipal utility's rates, then Franklin must refund any rates which exceeded the 1986 Supplemental Agreement rate and which have not yet received Commission approval. If, however, the Commission possesses such authority, then the Commission must review the reasonableness of rates which Franklin charged between April 23, 1993 and May 19, 1994 before ruling on Simpson District's motion.<sup>6</sup>

Franklin argues that, due to the unique circumstances of this case, the Commission may retroactively approve Franklin's wholesale rates. The central premise of Franklin's argument is that, had the Commission exercised its jurisdiction in the first instance, Franklin's current rates would have received Commission approval and have been in effect as of April 23, 1993. Since the Commission erred when it failed to exercise jurisdiction, it has the power to retroactively establish Franklin's rates.

A pervasive and fundamental rule underlying the utility rate-making process is that "rates are exclusively prospective in nature." New England Telephone And Telegraph Co. v. Pub. Util. Comm'n, 358 A.2d 1 (R.I. 1976). The rationale for this rule is that

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<sup>6</sup> To this end, the Commission ordered the parties to submit written briefs on this issue. See Order of April 4, 1995.

the Commission acts in a legislative capacity when exercising its rate-making authority. As rate-making orders have statutory effect, they are subject to the rules ordinarily applied in statutory construction. To accord a rate order retroactive effect requires "the clearest mandate." Claridge Apartments Co. v. Commissioner of Internal Revenue, 323 U.S. 141 (1944).<sup>7</sup>

KRS Chapter 278 contains no evidence that the Legislature conferred any authority upon this Commission to establish rates retroactively. KRS 278.200<sup>8</sup> expressly states that a contract rate between a city and a public utility may not be changed until a hearing has been held. KRS 278.180, which prescribes the method for changing rates, makes no provision for retroactive rate increases. KRS 278.270 provides that the Commission, upon finding a utility's existing rates to be unjust, unreasonable, or

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<sup>7</sup> This principle has been applied to preclude, almost without exception, utility regulatory commissions from engaging in retroactive rate-making. See, e.g., New England Tel. & Tel. Co. v. Public Util. Comm'n, 362 A.2d 741 (Me. 1976); Michigan Bell Tel. Co. v. Michigan Pub. Serv. Comm'n, 24 N.W.2d 200 (Mich. 1946); Wisconsin Telephone Co. v. Public Serv. Comm'n, 287 N.W. 122 (Wis. 1939).

<sup>8</sup> The commission may, under the provisions of this chapter, originate, establish, change, promulgate and enforce any rate or service standard of any utility that has been or may be fixed by any contract, franchise or agreement between the utility and any city, and all rights, privileges and obligations arising out of any such contract, franchise or agreement, regulating any such rate or service standard, shall be subject to the jurisdiction and supervision of the commission, but no such rate or service standard shall be changed, nor any contract, franchise or agreement affecting it abrogated or changed, until a hearing has been had before the commission in the manner prescribed in this chapter [emphasis added].

insufficient, "shall by order prescribe a just and reasonable rate to be followed in the future [emphasis added]."

The Commission's failure to entertain Franklin's complaint when filed does not confer any additional authority upon the Commission. See, e.g., Utah Power & Light Co. v. Idaho Public Utilities Comm'n, 685 P.2d 276 (Idaho 1984); Mountain States Telephone and Telegraph Co. v. New Mexico State Corp. Comm'n, 563 P.2d 588 (N.M. 1977).

Franklin also argues that Commission review of its wholesale rates is not rate-making and therefore is not subject to any prohibition against retroactive rate-making. It contends that municipal utility rates are presumptively valid and reasonable. In reviewing these rates, the Commission is not engaging in rate-making but merely affirming the municipal utility's rate.

Franklin's contention is wide of the mark. Even if the Commission merely accepts Franklin's proposed rates after hearings on the proposed rates, it engages in rate-making. By its acquiescence, it establishes new rates for the municipal utility to charge. Moreover, KRS 278.200, by requiring the Commission to hold a hearing on any proposed change in contract rate, implies that such changes are not presumptively valid and reasonable, but that their reasonableness must be adequately demonstrated.<sup>9</sup>

Since the Commission may not establish new rates for Franklin retroactively and since the rates charged between April 23, 1993

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<sup>9</sup> When viewed in conjunction with KRS 278.190(3), which imposes upon the requesting utility the burden of proof to show that the requested rate or charge is just and reasonable, this implication becomes even stronger.

and May 19, 1994 were neither rates for which the 1986 Supplemental Agreement provided nor rates which the Commission approved, Franklin could not lawfully charge those rates. Any rates charged and revenues collected which were in excess of the 1986 Supplemental Agreement's rate should be refunded. Accordingly, Simpson District's motion should be granted and an evidentiary hearing should be held to determine the amount of any overcharges.

The Commission's action should not be misconstrued. The Commission does not hold that the Supreme Court's holding in Simpson County should be retroactively applied to all municipal utilities providing utility service to public utilities. It does not hold that any changes to contracts between municipal utilities and public utilities prior to the Kentucky Supreme Court's decision in Simpson County are invalid or improper. To the contrary, the Commission presumes that, absent unusual circumstances, the rates which a municipal utility charged to its public utility customers as of April 21, 1994 are proper and valid. As to the parties to this proceeding, however, the Supreme Court has expressly held that Franklin's efforts since 1988 to adjust its rates beyond the limits provided in the 1986 Supplemental Agreement without Commission approval are an "improper engagement in rate making," Simpson County at 463, and that express Commission approval for those actions was required.

Before any review of Franklin's proposed rates, the Commission will require Franklin to supplement its complaint. In Case No. 95-

044,<sup>10</sup> the Commission held that, when applying for an adjustment of its wholesale rates, a municipal utility must comply with the requirements of Commission Regulation 807 KAR 5:001, Section 10. This regulation provides the minimum information needed to review a rate application. Franklin has not filed any of the information required by this regulation. Until that information is provided, no action can be taken on its application.

IT IS THEREFORE ORDERED that:

1. Simpson District's Motion for Recovery is granted.
2. Franklin shall refund to Simpson District all monies collected in excess of the rate specified in the 1986 Supplemental Agreement.
3. Unless the parties stipulate the amount of any overcharge, a hearing in this matter shall be held on February 28, 1996 at 10:00 a.m., Eastern Standard Time, in Hearing Room 1 of the Commission's offices at 730 Schenkel Lane, Frankfort, Kentucky for the purpose of determining the amount of monies, if any, which Franklin collected from April 23, 1993 to May 19, 1994 in excess of the rate specified in the 1986 Supplemental Agreement.
4. Each party shall file, within 20 days of the date of this Order, the written direct testimony of all witnesses whom it intends to call at the scheduled hearing.
5. Within 60 days of the date of this Order, Franklin shall supplement its complaint to comply with the requirements of 807 KAR

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<sup>10</sup> Case No. 95-044, The Application of Bowling Green Municipal Utilities for an Increase in Water and Sewer Rates to Warren County Water District (April 7, 1995).



5:001, Section 10. Franklin's failure to comply with this provision will result in dismissal of Franklin's complaint.

Done at Frankfort, Kentucky, this 18th day of January, 1996.

PUBLIC SERVICE COMMISSION

Linda K. Breathitt  
Chairman

E. J. Wilson  
Vice Chairman

Robert M. Davis  
Commissioner

ATTEST:

Don Mills  
Executive Director

APPENDIX 1

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION  
IN CASE NO. 92-084 DATED JANUARY 18, 1996

**CHRONOLOGY OF EVENTS**

<u>Date</u>	<u>Event</u>
4/5/67	Simpson County Water District and City of Franklin enter a water supply contract.
8/26/82	Simpson County Water District and City of Franklin enter Supplemental Agreement. Specified rate is 54 cents per 1,000 gallons.
4/3/86	Simpson County Water District and City of Franklin enter Second Supplemental Agreement. Specified rate is 84.78 cents per 1,000 gallons.
6/25/90	City of Franklin enacts ordinance which increases the rate which Simpson County Water District must pay to \$1.3478 per 1,000 gallons (59% increase). Simpson County Water District refuses to pay the increased rate.
5/13/91	City of Franklin enacts second ordinance which increases the rate charged to Simpson County Water District to \$1.68 per 1,000 gallons. Simpson County Water District refuses to pay the increased rate and continues to pay the 1986 Supplemental Agreement rate.
8/26/91	City of Franklin files an action to collect unpaid charges in Simpson Circuit Court.
11/12/91	Simpson Circuit Court dismisses the City of Franklin's action for lack of subject matter jurisdiction.
3/4/92	City of Franklin files its complaint against Simpson County Water District with the Public Service Commission.
5/26/92	Public Service Commission dismisses the portion of the City of Franklin's complaint which sought Commission approval of its rates.

1/8/93	Kentucky Court of Appeals reverses the judgment of Simpson Circuit Court.
1/26/93	Simpson County Water District files a motion for discretionary review with the Kentucky Supreme Court.
4/16/93	City of Franklin threatens to terminate Simpson County Water District's service unless the arrearage is paid or a supercedas bond is posted.
4/23/93	Simpson Circuit Court denies Simpson County Water District's motion for temporary injunction and holds that service may not be discontinued only if Simpson County Water District agrees to pay City of Franklin's demanded rate.
1/31/94	Kentucky Supreme Court reverses the Court of Appeals and affirms the Simpson Circuit Court decision.
4/21/94	Kentucky Supreme Court denies motion for rehearing. 1/31/94 decision is final.
5/19/94	Simpson County Water District begins receiving water service from White House Utility District. No further purchases are made from the City of Franklin.